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IN THE

Supreme Court of The United States

OCTOBER TERM, 1980

No. 79-1598

THE M. J. KELLEY COMPANY
Petitioner,

vs.

JAYNE ANN WOODS,
Commissioner of Revenue
for the State of Tennessee,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

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for the State of Tennessee,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

The Petitioner, The M. J. Kelley Company, respectfully prays that a writ of certiorari be issued to review the judgment and opinion of the Supreme Court of Tennessee. Respondent herein is Jayne Ann Woods, Commissioner of Revenue for the State of Tennessee.

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee, reported at 592 S.W.2d 567 (1980), dated January 14, 1980, appears in the appendix hereto (App. C, A-8).

The memorandum, opinion and judgment of the Chancery Court for Davidson County, Tennessee, dated October 10, 1978, which is unreported, appears in the appendix hereto (App. B, A-6).

JURISDICTION

The judgment of the Supreme Court of Tennessee, the court of final jurisdiction in the State of Tennessee, was entered on January 14, 1980 (App. C, A-8). Said judgment reversed the order and judgment of the Chancery Court for Davidson County, Tennessee.

This Petition for Certiorari was filed within 90 days of that date. The jurisdiction of the Supreme Court of the United States is invoked pursuant to 28 U.S.C. §1257(3).

QUESTIONS PRESENTED

1. Whether the Supreme Court of Tennessee has interpreted the taxing statutes of the State of Tennessee so as to result in a tax upon the use of interstate commerce in violation of Article I, Section 8 of the United States Constitution.

2. May the State of Tennessee impose a use tax burden upon a taxpayer solely because he caused foreign goods to be shipped in interstate commerce into the State of Tennessee?

3. Can the State of Tennessee treat the use of interstate commerce as a taxing incident subject to the Tennessee use tax?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, Section 8, Clause 3 of the Constitution of the United States is reproduced in the Appendix hereto (App. D, A-19).

STATEMENT OF THE CASE

Kelley is a mechanical contractor with its principal place of business in Cleveland, Ohio. Between May 1, 1973, and March 31, 1975, Kelley was a subcontractor in connection with the construction of the United States Bulk Mail Center in Memphis, Tennessee. Kelley, however, entered into subcontracts whereby third party subcontractors would install the materials on the project. The State of Tennessee brought suit against Kelley for collection of use taxes allegedly owed by Kelley arising out of Kelley's causing materials to be shipped into Tennessee from foreign states. The use tax was imposed on the sales price of these materials.

As a result of Kelley's subcontracting out all of the work, its only function was to coordinate the shipment of materials (most of which came from out of the State of Tennessee) to the job site for use by labor subcontractors. These subcontractors assumed full control and ownership of the materials upon delivery to the project.

As a result of an audit by the State of Tennessee, Kelley was assessed Tennessee use tax on all equipment and materials shipped into Tennessee for use in the construction of the project which were delivered as a result of contracts Kelley had with various material suppliers and fabricators. Only those materials delivered to the project by out-of-state companies and installed by labor subcontractors were subject to the use tax. Kelley was not taxed for materials used by subcontractors which were not shipped in interstate commerce.

The ownership of materials was never in Kelley, title being vested in the suppliers initially and in the subcontractors at the time of delivery.

While the trial court rejected the State's claim and assessment (App. B, A-6), the Supreme Court of Tennessee reversed the

lower court's ruling, and in doing so, subjected Kelley to taxation as a result of its causing materials to be shipped in interstate commerce (App. C, A-8).

How The Federal Question Was Presented.

While Kelley raised the constitutional issue at trial, the Court's decision was not based on that issue (App. B, A-6). On appeal, Kelley again raised the issue and the Supreme Court of Tennessee responded to it (App. C at page 9, A-14). Furthermore, T.C.A. §67-3007 (App. E, A-20) recognizes the constitutional bar to taxation of interstate commerce. While the Supreme Court recognized the existence of the constitutional prohibition and the Tennessee statute, the court's opinion permits imposition of the use tax in cases where the sole taxing incident is the shipping of goods into the state in interstate commerce.

While Kelley specially set up and claimed application of Article I, Section 8 of the Constitution of the United States, the Supreme Court of Tennessee rejected Kelley's contention. The Tennessee Supreme Court in its opinion ignores the clear burden to interstate commerce and deterent to the use of interstate commerce by a taxpayer which results when the use tax is levied upon a party when the sole basis for imposition of the tax is the taxpayers' shipping of property in interstate commerce into the State of Tennessee for the use in the state by a third party.

The holding and interpretation of the Tennessee use tax by the Tennessee Supreme Court is contrary to this Court's pronouncements prohibiting the taxation of interstate commerce itself. *Henneford* v. *Silas Mason Co.*, 300 U.S. 577, 57 S.Ct. 524 (1937); *Halliburton Oil Well Cementing Company* v. *Reily*, 374 U.S. 858, 83 S.Ct. 1861 (1963); *Best & Co.* v. *Maxwell*, 311 U.S. 454, 455, 456, 61 S.Ct. 334, 335 (1940).

Discrimination against interstate commerce and the taxpayer who engages in interstate commerce results from the Tennessee Supreme Court's opinion.

The lower court apparently views the Tennessee use tax statute as permitting a tax upon the "use" of interstate commerce. The court failed to consider whether such an interpretation results in discriminatory treatment of interstate commerce and taxpayers engaged in interstate commerce.

REASONS THE WRIT SHOULD BE GRANTED

This petition presents questions of the extreme public importance involving the transportation of goods in interstate commerce and the authority of states to expand their role as tax collector. In this case, the Tennessee Supreme Court has decided a substantial federal question in disregard of prior rulings of this Court and has effectively negated the commerce clause of the United States Constitution as previously enunciated by this Court. In short, there exists compelling reasons for granting this writ.

1. The Interpretation Of The Tennessee Use Tax Act By The Tennessee Supreme Court Discriminates Against Taxpayers Making Use of Interstate Commerce.

Contrary to the decisions of this Court, the Tennessee Supreme Court has declared that the commerce clause does not prohibit discriminatory taxation of interstate commerce and taxpayers engaged in interstate commerce. *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318, 97 S.Ct. 599 (1977); *Halliburton Oil Well Cementing Company* v. *Reily, supra; Galveston, H.& S.A.R. Co.* v. *Texas*, 210 U.S. 217, 28 S.Ct. 638 (1908); *McLeod* v. *Dilworth*, 322 U.S. 327, 64 S.Ct. 1023 (1944).

Under the Tennessee Use Tax Act, ownership of property is not determinative of whether the use tax can be imposed.

Rather, under the Tennessee act "use" applies to the exercise of any right or power over tangible personal property. *See,* T.C.A. 67-3002(h) (App. F, A-21). The Supreme Court of Tennessee reasoned, pursuant to T.C.A. 67-3004 (App. G, A-22), that one use of personal property which is taxable is the shipment of property in interstate commerce into the State of Tennessee for ultimate use within the state. The proper party to be taxed, the court reasons, is a party who "uses" the materials by causing them to be shipped in interstate commerce for ultimate consumption in the state. The court notes that T.C.A. 67-3004 provides for such an imposition because the Act taxes a person who "uses tangible personal property in the performance of his contract." The court considers that the shipping of goods in interstate commerce in connection with the carrying out of a contract obligation falls within the above provision.

The court expressed its belief in the taxation of causing goods to be shipped into the state when it stated:

> When a contractor brings in materials from outside the state for use in this state on a project which benefits and profits that contractor, it has used the materials in such a way that it must be liable for the use tax. (App. C at page 13).

The court further indicates elsewhere the opinion that the act of bringing goods into the state is alone a basis for taxation:

> The materials were delivered, and came to rest within the State. They were unloaded and installed pursuant to Kelley's contracts with North American and Delta [subcontractors]. Thus, this tangible personal property, brought into the State for use and construction here, became a part of the "mass property in this State." Section 67-3007, T.C.A. (App. E at page 12-13, A-20).

In essence, the supreme Court of Tennessee interprets the Tennessee Use Tax Statute as compelling imposition of the tax

upon a taxpayer solely because the taxpayer caused materials to be shipped in interstate commerce into the state regardless of the lack of ownership or control of the goods. Kelley, thus, is taxed not because of its control over the materials before they came to rest within the State or after the property became a part of the mass of property in the State, but because of Kelley's use of interstate commerce in bringing the goods into Tennessee. Such a determination is discriminatory to those who ship materials in interstate commerce from outside the state.

The use tax statutes normally operate in practice to tax the enjoyment of property purchased. *McLeod* v. *Dilworth, supra.* However, the Tennessee Supreme Court has extended application of the Tennessee use tax to tax the act of shipping property into the State of Tennessee, contrary to the constitutional mandate of the commerce clause. As noted by this Court in numerous cases, the commerce clause was meant to create an area of free trade among the several states. *McLeod* v. *Dilworth,* 322 U.S. 327, 330, 64 S.Ct. 1023, 1026 (1944); *Great Atlantic & Pacific Tea Co.* v. *Cottrell,* 424 U.S. 366, 96 S.Ct. 923 (1976).

Further, this Court has stricken down use tax acts when those acts are found to burden interstate commerce by discriminating against the acquisition of foreign goods. *Henneford* v. *Silas Mason Co., supra; Halliburton Oil Well Cementing Company* v. *Reily, supra.* Other taxing statutes which burden and discriminate against interstate commerce have likewise been declared unconstitutional. *Nippert* v. *City of Richmond,* 327 U.S. 416, 66 S.Ct. 586 (1946); *Boston Stock Exchange* v. *State Tax Commissioner of New York, supra.*

The discriminatory burden on interstate commerce arising from the Tennessee Supreme Court's opinion is clear. A contractor or shipper, like Kelley, who causes materials not owned by him to be delivered by an in-state supplier or manufacturer to an in-state user or installer for use in the state has no tax

burden, since the Tennessee sales tax, T.C.A. 67-3018, would hold the dealer (manufacturer or seller) responsible for payment of the tax to the State (App. H, A-23). The Tennessee use tax act would not apply since the materials were not caused to be shipped in interstate commerce into the State for use in the State. However, when, as in the instant case, a taxpayer causes materials to be sent into the State of Tennessee by interstate commerce for use in the state by a third party, the State imposes the use tax upon the taxpayer because of his "use" of the materials by causing them to be shipped into the State of Tennessee. Obviously, the non-resident, like Kelley, can avoid both use and sales taxes by dealing with resident manufacturers and suppliers since such suppliers and manufacturers are responsible for payment of the state sales tax. Such a result discourages interstate commerce and discriminates against the shipping of materials into the State of Tennessee from out of state.

In the instant case, Kelley was not charged either use or sales tax with respect to its dealings with Tennessee companies who provided both the materials and the installation of these materials. Rather, the full tax burden was borne by these suppliers and installers. Only when Kelley, a non-resident, elected to have materials shipped into the State of Tennessee for installation by a third party subcontractor did Kelley incur liability for the use tax.

As this Court stated in *Halliburton Oil Well Cementing Company* v. *Reily, supra,* at 70 and 1204:

> The conclusion is inescapable, equal treatment for instate and out-of-state taxpayers similarly situated is a condition precedent for a valid use tax on goods imported from out of state.

The effect of the Tennessee Supreme Court's decision not only discriminates between in-state and out-of-state taxpayers per se but more clearly discriminates between doing business with out-of-state suppliers as opposed to in-state suppliers. The

resulting effect in discouraging interstate commerce is at least equal to a per se discrimination between in-state and out-of-state taxpayers similarly situated. In fact, the pronouncement of the Tennessee Supreme Court most likely results in a greater discrimination against interstate commerce since its effect is to tax a party causing goods to be brought into the state when that party would incur no tax at all by availing itself of in-state suppliers.

The effect of such a tax is to encourage a party engaging in business within the State of Tennessee to rely exclusively on in-state suppliers of materials, a result which, in light of this Court's previous pronouncement, would be contrary to the purpose of the commerce clause. See, *Dean Milk Co.* v. *Madison,* 340 U.S. 349, 71 S.Ct. 295 (1951); *Nippert* v. *City of Richmond, supra.*

The taxation scheme of the State of Tennessee does not provide substantially even handed treatment to those taxpayers who are involved in the procurement of materials from out-of-state as opposed to the procurement of in-state materials. There is absolutely no corresponding sales tax liability for a party procuring, but not purchasing, materials from an in-state supplier. Such a scheme results in obvious discriminatory treatment if the taxpayer avails himself of interstate commerce in bringing goods into the State of Tennessee.

As this Court has previously enunciated, the entire scheme of taxation is to be considered in determining whether there exists an impermissible burden on interstate commerce. See, *Galveston H&SAR Co.* v. *Texas, supra; Best & Co.* v. *Maxwell, supra.* As the court stated in *Henneford,* the tax burden from an out-of-state acquisition must be "balanced by an equal burden where the sale is strictly local." At 584 and 527.

The Tennessee Supreme Court has made an improper distinction between taxpayers who contract for the use in construction of out-of-state goods as opposed to those who contract for the

use of in-state goods. While this Court condemned by reference such a result in *Henneford,* more often this Court has directed its attention to discrimination between in-state and out-of-state taxpayers. While the Supreme Court of Tennessee has not specifically made such a distinction between in-state and out-of-state taxpayers, the effect is still discriminatory treatment of persons engaged in interstate commerce and, in fact, operates to tax the use of interstate commerce.

2. This Court Should Condemn The Taxation Of The Use Of Interstate Commerce Even When Such Taxation Results From Artfully Devised Interpretations Of Lawful Statutes.

This Court has previously condemned state regulations and taxes which interfere and burden the natural functioning of interstate commerce. *See, Western Live Stock* v. *Bureau of Revenue,* 303 U.S. 250, 58 S.Ct. 546 (1938); *Toomer* v. *Witsell,* 334 U.S. 385, 68 S.Ct. 1156 (1948); *Pike* v. *Bruce Church, Inc.,* 397 U.S. 137, 90 S.Ct. 844 (1970).

In *McGoldrick* v. *Berwind-White Coal Mining, Co.,* 309 U.S. 33, 45, 60 S.Ct. 388, 1391 (1940), this Court stated:

> Forms of state taxation whose tendency is to prohibit the commerce or place it at a disadvantage as compared or in competition with interstate commerce and any state tax which discriminates against the commerce, are familiar examples of the exercise of state taxing power in an unconstitutional manner ...

The State of Tennessee by imposing a use tax upon Kelley and taxpayers who cause materials to be shipped in interstate commerce has interfered with and burdened the very act of engaging in interstate commerce. The element which triggers imposition of the Tennessee use tax is the act of engaging in interstate commerce itself.

While it is permissible to impose a tax upon property shipped in interstate commerce before its movement begins, or after it comes to an end, the Tennessee Supreme Court has applied the use tax beyond these bounds of permissible taxation. See, *Brown* v. *Houston,* 114 U.S. 622, 5 S.Ct. 1091 (1885); *Federal Compress & Warehouse Co.* v. *McLean,* 291 U.S. 17, 54 S.Ct. 267 (1934); and *Eastern Air Transport, Inc.* v. *South Carolina Tax Commission,* 285 U.S. 147, 52 S.Ct. 340 (1932). This Court in *Henneford* v. *Silas Mason, supra,* recognized also that a tax imposed directly upon interstate commerce would be beyond a state's power. In *Henneford,* the Court sustained the tax upon property which had "come to rest within the state." The taxing event in the instant case occurred after materials were shipped, but before they came to rest in Tennessee as property owned by the subcontractors.

The imposition of the use tax in the instant case upon Kelley, is analogous to the facts that this Court found in *Michigan-Wisconsin Pipeline Co.* v. *Calvert,* 347 U.S. 157, 74 S.Ct. 396 (1954). There this Court looked to the "taxable incident" and found that in effect a Texas tax operated to tax the actual transmission of products in interstate commerce. The Court found that the taxable incident occurred while the product was in the course of interstate commerce and, therefore, was an unlawful exercise of the state's taxing power. The taxation by the State of Tennessee because of Kelley's causing materials to be placed in interstate commerce should likewise be condemned. See also, *Joseph* v. *Carter and Weekes Stevedoring Company,* 330 U.S. 422, 427, 67 S.Ct. 815, 818, (1947).

On other occasions, this Court has rejected as impermissible burdens on commerce certain forms of taxation imposed essentially in the use of interstate commerce. *Spector Motor Service* v. *O'Connor,* 340 U.S. 602, 71 S.Ct. 508 (1951); *Memphis Steam Laundry Cleaner* v. *Stone,* 342 U.S. 389, 72 S.Ct. 424 (1952); *Halliburton Oil Well Cementing Co.* v. *Reily, supra.* The Court has reached these decisions in spite of artfully de-

vised legislation or interpretations of lawful statutes. This Court has recognized that regardless of the name given to a particular taxing statute or judicial construction made, it is more important to view the constitutionality of the statute or its application based upon the practical operation of the act and its effect on interstate commerce. See, *Best & Co.* v. *Maxwell, supra.* Regardless of how the Supreme Court of Tennessee characterizes its interpretation, the practical effect of its interpretation is to expand the application of the Tennessee Use Tax Act to include taxation on interstate commerce itself.

The applicability of the commerce clause should not be limited or denied in the present case. The effect of permitting states to devise ingenious methods of raising additional revenue in times of economic hardship is detrimental to the free flow of commerce between states and persons who depend upon the use of interstate commerce as an intrical part of their business operations.

The holding of the instant case permits and encourages the placing of unlawful tax burdens on interstate commerce, which have been uniformly rejected by this Court and which should again be rejected to prevent other forms of unconstitutional taxation.

CONCLUSION

The Tennessee Supreme Court decision is contrary to the decisions of this Court and the purposes of the commerce clause of the Constitution of the United States. The decision ignores the burden placed upon interstate commerce by taxing persons who utilize that commerce in carrying on business. This Court has repeatedly recognized and condemned such effects upon the commerce between states.

The denial of free and open commerce between states and equal application of taxing statutes discourages interstate commerce and is adverse to the public interest. For these reasons, the writ of certiorari should issue to review the Judgment and Opinion of the Tennessee Supreme Court, and this Court should reverse and remand the instant case to the Tennessee Supreme Court for entry of an opinion and judgment consistent with this court's previous rulings.

Respectfully submitted,

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Certificate of Service

I hereby certify that on this 10th day of April, 1980 three (3) copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to Joe C. Peel, Assistant Attorney General for the State of Tennessee, 450 James Robertson Parkway, Nashville, Tennessee, 37219, Counsel for Respondent. I further certify that all parties required to be served have been served.

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Appendix

APPENDIX A

Jayne Ann Woods,
Commissioner of Revenue
of the State of Tennessee

vs. 77-545-III

The M.J. Kelley Company

In the Chancery Court,
For Davidson County,
Part Three,
At Nashville, Tennessee.

MEMORANDUM

(Filed September 15, 1978)

This is a suit brought by the State Department of Revenue pursuant to T.C.A. § 67-6032(a) to collect the use tax, interest and penalty on certain property purchased outside the State by M.J. Kelley Company and shipped to a Memphis, Tennessee construction site for installation at a U.S. Postal Service facility.

The Court concludes that the defendant's tax liability is limited to a tax on that property fabricated or installed by the M.J. Kelley Company and that it is not liable for taxes on property fabricated and/or installed by its labor subcontractors.

The defendant, M.J. Kelley Company, an Ohio corporation, was the subcontractor for heating, plumbing, air conditioning and related systems at the bulk mail facility in Memphis.

As a second-tier subcontractor, the defendant's responsibilities included furnishing a performance bond to cover all mechanical work, subcontracting out labor and material work to third-tier subcontractors, organizing the delivery of materials, and overseeing general compliance with specifications. A labor dispute did require the defendant to install a small amount of property itself on which it does not contest use tax liability.

The defendant employed a maximum of three persons at the Memphis site, a project manager, an assistant, and a secretary.

The usual procedure involved the purchasing by the defendant of materials from its material subcontractors for use on the project by its labor subcontractors, North American Mechanical and Delta Mechanical. These materials, most of which were purchased by the defendant in Ohio, were shipped by common carrier or by the defendant M.J. Kelley Company to Memphis where they were unloaded at the construction site and installed by the labor subcontractors.

The form labor contracts entered into by the defendant and the subcontractors provided that the subcontractor would be "responsible for all his materials delivered to the site, or installed in the work, from inception of delivery until final acceptance of the work by the owner." It was the responsibility of the labor subcontractor to make any damage claims regarding the shipped goods. Should they not do so, the labor subcontractor absorbed the loss. Storage at the construction site was also the responsibility of the labor subcontractor.

In some cases, however, the material subcontractor also installed its material at the construction site. The State did not include these materials as taxable in its audit of the defendant because the subcontractor "furnished and installed the materials used in completing the contract." (Ex. 11).

The State contends that the defendant should be assessed the use tax on all materials installed by its labor subcontractors. The defendant's position is that since it did not "use" the materials as that term is statutorily defined, it cannot be taxed on them.

The use tax is a tax upon the privilege of using, consuming, distributing or storing tangible personal property after it is brought into Tennessee from without the state. The primary purpose of the tax is to prevent the evasion of Tennessee state sales tax by persons purchasing tangible personal property outside

the State of Tennessee for use within the state. *Broadacre Dairies, Inc.* v. *Evans,* 193 Tenn. 441, 246 S.W.2d 78 (1952).

T.C.A. § 67-3003 provides in part that "every person is exercising a taxable privilege . . . who uses or consumes in this State any item or article of tangible or personal property . . . irrespective of the ownership thereof."

T.C.A. § 67-3004 provides:

* * *

> Where a contract or a subcontractor hereinafter defined as a dealer, uses tangible personal property in the performance of his contract, or to fulfill contract or subcontract obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the title holder of such property would be subject to pay the sales or use tax, . . . such contractor or subcontractor shall pay a tax at the rate prescribed by Section 67-3003 measured by the purchase price or fair market value of such property, whichever is greater, unless such property has been previously subjected to a sales or use tax, and the tax due thereon has been paid.

T.C.A. § 67-3005 provides in part:

> On all tangible personal property imported, or caused to be imported from other states or foreign country, and the "dealer" as defined in Section 67-3017, shall pay the tax imposed by this chapter on all articles of tangible property so imported and used, the same as if the said articles had been sold at retail for use or consumption in this State.

The essential element on which the imposition of this tax is predicated is use by the taxpayer. Use is defined in T.C.A. § 67-3002(h) as

> The exercise of any right or power over tangible personal property incident to the ownership thereof, except

that it shall not include the sale at retail of that property in the regular course of business.

The State argues that the "apparent ability [of the defendant] to transfer the property to another contractor for erection" constituted taxable use. Alternatively, the State contends that M.J. Kelley Company is liable for the tax because the labor subcontractors who installed the material were its agents.

The use tax is intended to tax the actual enjoyment of the property purchased outside this state after it has come to rest here and is no longer in interstate commerce. *Young Sales Corporation* v. *Benson,* 450 S.W.2d 574 (Tenn. Sup. Ct. 1970). The decisive point in time for determining taxation is the time at which interstate commerce of the materials terminates. The fact that a party has title to or control over the goods while they are in interstate commerce is irrelevant for purposes of the use tax. Rather, the tax falls on those persons who use, consume, distribute, or store the property after it has been imported and come to rest inside Tennessee. *Broadacre Dairies, Inc.* v. *Evans, supra.* Thus, the fact that some of the property may have been shipped by M.J. Kelley or that it was the owner of the goods, would not establish liability for use taxes on the property. Liability can only be established by a demonstration of use through the exercise of a right of power over the property after it came to rest in Memphis, Tennessee. The proof shows no such exercise. The goods were unloaded, fabricated and installed at the construction site by the labor subcontractors. There is no evidence that M.J. Kelley Company exercised any control over the property after the time it ceased to be interstate commerce. Since the defendant did not "use" the materials within the meaning of the statute, it cannot be taxed on their value.

The State also argues that the fact actual use by M.J. Kelley cannot be established would not relieve it of tax liability since the labor subcontractors who used the materials did so as M.J. Kelley's agents. This argument is not persuasive. Whether a

party is an agent or an independent contractor is based on the extent of control exercised over the performance of the work. This may be determined by the facts and circumstances surrounding the contractual relationship, and by the intention of the parties as expressed in the contract. *Carbide and Carbon Chemicals Corporation* v. *Carson,* 192 Tenn. 150, 160, 239 S.W.2d 27, 31 (1950), *United States* v. *Boyd,* 363 S.W.2d 193 (Tenn. Sup. Ct. 1962). The surrounding circumstances and the contracts involved in this case establish that the labor subcontractors who used the materials were independent contractors, not agents. No control was exerted by M.J. Kelley Company in the supervision of the installation of the materials. Each subcontractor had the responsibility for hiring its own employees and furnishing their own tools and equipment.

A use tax may therefore not be assessed against the defendant on property fabricated and/or installed by the labor subcontractors. A use tax may be assessed against the defendant on that property which the defendant itself fabricated and/or installed.

A decree will be entered incorporating this memorandum by reference and awarding a judgment against the defendant for taxes due for the property actually fabricated and installed by the defendant, and such penalty and interest as provided by law. A decree will be submitted signed by both counsel. If the parties are unable to agree on the amount of tax, penalty, and interest, each party will submit a proposed decree and a statement supporting its position. Costs are taxed to the defendant.

/s/ ROBERT S. BRANDT, CHANCELLOR

September 15, 1978

cc: Charles Moore
John C. Speer

APPENDIX B

DECREE ENTERED OCTOBER 10. 1978—M.B. 6, Page 493. CHANCERY COURT OF DAVIDSON COUNTY TENNESSEE

Jayne Ann Woods,
Commissioner of Revenue
of the State of Tennessee

Plaintiff,

v. NO. 77-545-III

The M.J. Kelley Company,

Defendant.

ORDER AND JUDGMENT

I hereby certify that this is a true copy of original instrument filed in my office. This 16th day of October, 1978.

RAYMOND L. BARRETT
Clerk & Master

By Doris Ann Willis
Deputy Clerk

This cause came on to be heard on the complaint of Jayne Ann Woods, Commissioner of Revenue of the State of Tennessee; the Answer filed by the defendant, the M. J. Kelley Company; the testimony of the parties and their witnesses before the Court sitting without a jury; and the entire record in this issue.

From all of the above it appears to the Court that the tax liability of The M. J. Kelley Company is limited to the tax on that property fabricated or installed by The M. J. Kelley Company with respect to the United States Bulk Mail Center located in Memphis, Tennessee, said property being at a value of $17,077.44 with a total tax liability, including interest and penalty in the amount of $1,235.27.

It appears to the Court that the balance of the tax assessment made on property fabricated and/or installed by labor subcontractors is not recoverable for the reasons set forth in this Court's Memorandum filed September 15, 1978, a copy of which is attached to this decree and incorporated in this Order by reference.

IT IS, THEREFORE, ORDERED, that judgment be entered in favor of the plaintiff, Jayne Ann Woods, Commissioner of Revenue of the State of Tennessee, in the amount of $1,235.27, and all costs are to be taxed to the defendant for which execution may issue. Plaintiffs excepts to that part of the above judgment which is adverse to her and prays for an appeal to the Supreme Court of Tennessee at Nashville which appeal is hereby granted. Plaintiff is granted ninty (90) days in which to file the Bill of Exceptions.

/s/ Robert Brandt
CHANCELLOR

10 October 1978
DATE:

APPROVED:

/s/ Charles T. Moore
Attorney for Plaintiff

/s/ John c. Speer
Attorney for Defendant

APPENDIX C

IN THE SUPREME COURT OF TENNESSEE

AT

NASHVILLE

January 14, 1980
FOR PUBLICATION

DAVIDSON EQUITY

HONORABLE ROBERT S. BRANDT, CHANCELLOR.

Jayne Ann Woods, Commissioner of Revenue
For the State of Tennessee
Plaintiff-Appellant

vs.

The M.J. Kelley Company
Defendant-Appellee

For Appellant

William M. Leech, Jr.
The Attorney General

Joe C. Peel
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For Appellee

John C. Speer
Heiskell, Donelson, Williams,
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OPINION

Filed
Jan. 14, 1980

REVERSED & REMANDED HENRY, J.

The question before the Court is whether an out-of-state contractor[1] doing business in Tennessee should be liable for a use tax on materials which it caused to be delivered to a construction site in Memphis, where they were installed by labor subcontractors, pursuant to contracts with the out-of-state contractor.

We conclude that the contractor has used these materials in Tennessee in such a manner that it is liable under Sections 67-3001, *et seq.*, T.C.A., for the use tax assessed by the Tennessee Department of Revenue.

I.

From May 1973 through March 1975, the appellee, The M.J. Kelley Company, was acting as a contractor[1] on a project involving the construction of a bulk mail facility at Memphis. Kelley, a mechanical contractor incorporated in Ohio, had bid and obtained the contract for the mechanical portion of the job. Kelley's portion of the job involved the plumbing, heating, air conditioning and sprinkler work on the building.

In order to fulfill its contractual obligations Kelley entered into several subcontracts for materials and labor needed to complete the mechanical phase of the construction job. We concern ouselves primarily with Kelley's subcontracts with North American Mechanical, Inc., and Delta Mechanical Contractors, Inc., both of Memphis.

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[1] The appellee, The M.J. Kelley Company was a second-tier subcontractor on this construction project. For the sake of convenience, however, Kelley will be referred to as the contractor and North American and Delta, third-tier subcontractors, as subcontractors.

Kelley, following its usual practice of hiring local subcontractors to do the work, contracted with North American and Delta to install the materials which Kelley was to supply.[2] North American Mechanical was to install the duct work, and both North American and Delta were to install plumbing and heating materials provided by Kelley. North American and Delta were to perform the work in accordance with the specifications and plans to the satisfaction and acceptance of Kelley and the owner. Kelley itself was responsible for having the materials meet specifications.

To meet the material needs of the job, Kelley engaged material subcontractors to manufacture and fabricate the materials necessary to carry out the project. For example, Kelley had a contract with Hodous and Friedman for sheet metal fabrication; Kelley directed that these materials be delivered to it at the Hodous and Friedman factory and agreed to reimburse Hodous and Friedman for loading the materials on Kelley trucks. The majority of the materials for the project in Memphis were purchased by Kelley out of state. No sales tax was paid on these materials. On those materials purchased in Tennessee, Tennessee sales tax was paid; they are not involved in this controversy. Destination and mode of delivery of the materials varied.

Kelley originally agreed to unload the materials in Memphis and move them to the bay in the building where they were to be installed by the subcontractors. The subcontractors' contracts were to begin at that point. Kelley's Project Administrator,

[2] Certain of the subcontracts made by Kelley were for both labor and materials. For example, Erie View Insulation Company provided all labor and materials in connection with insulation of the building. On a contract such as this, where the third-tier subcontractor was a responsible for obtaining his own materials and thus had the records on the cost of these items, the State Department of Revenue collected the use tax from the subcontractor, Erie, and not from Kelley.

Raymond Zetts, testified, however, that North American personnel actually unloaded the materials.

Kelley also provided, pursuant to its contracts with North American and Delta, rigging, scaffolding and "related type services" necessary for the project.

Near the completion of the project North American, Delta and Kelley became involved in a labor dispute. Kelley had reserved in its contracts with North American and Delta the right to discharge these labor subcontractors should their work not be satisfactory. Both North American and Delta left the job. Kelley then employed local union personnel and finished the project. The materials that Kelley used in completing the project after terminating North American and Delta were assessed and this portion of the tax assessment is not disputed.

Throughout the project Kelley maintained a staff at the site, including the project manager, a secretary and sometimes an assistant. The function of this small staff was the oversight and coordination of the work of the subcontractors and the processing of necessary paper work.

II.

In May 1975 personnel from the State Department of Revenue conducted an audit at Kelley's office in Cleveland, Ohio. Kelley's records showed that the materials it needed for the bulk mailing facility project were purchased primarily from out-of-state vendors. In some instances the materials were delivered to Kelley in Cleveland and no sales or use tax was charged. On the material that was shipped directly to Tennessee, if the vendor was registered in Tennessee, the Tennessee tax was paid. If the vendor was not registered in Tennessee, no tax was paid.

The audit did not include items upon which Kelley had paid Tennessee sales tax. Certain adjustments were made to the audit, and the final use tax liability of Kelley was determined to

be forty-five thousand nine hundred seventy-five and 75/100 dollars ($45,975.75). Kelley refused to pay this assessment.

The State Department of Revenue then filed a tax lien and ultimately brought this suit pursuant to Section 67-6032(a), T.C.A., to collect the use tax, interest and penalty.

After the hearing, the Chancellor entered a memorandum opinion in which he held that Kelley's tax liability was limited to those materials which were installed under Kelley's direct supervision of local union labor hired after Kelley terminated North American and Delta. The Chancellor found that Kelley was not liable for the use tax assessed on those materials purchased and imported by Kelley if the materials were installed by the subcontractors hired by Kelley.

The State Department of Revenue appeals the Chancellor's decision. The State maintains, and we agree, that the Chancellor's decision would narrow the application of the use tax to those instances in which the taxpayer physically manipulated the tangible personal property in question. Appellee Kelley responds that the Chancellor has not so narrowed the application of the use tax but instead has reiterated a fundamental element of the use tax that the taxpayer itself must use the materials before liability for the tax attaches.

III.

The use tax is a compensating tax, designed to prevent the avoidance of sales taxes and ensure that Tennessee manufacturers and merchants remain on equal competitive footing with nonresidents who enter this state to do business. *Broadacre Dairies, Inc.* v. *Evans*, 193 Tenn. 441, 246 S.W.2d 78 (1952). Taken together, the sales and use taxes provide a uniform scheme of taxation on goods (tangible personal property) purchased within the state and goods purchased outside the state for "storage, use, or consumption" within the state. *Broadacre Dairies, supra. See also, Henneford* v. *Silas Mason Co., Inc.*, 300 U.S. 577, 81 L.Ed. 814, 57 S. Ct. 524 (1936).

Broadly speaking, the use tax is a tax "on the enjoyment of that which was purchased, after a sale has spent its interstate character." *McLeod* v. *Dilworth*, 322 U.S. 327, 88 L.Ed.1304, 64 S. Ct. 1023 (1943). More specifically, the use tax is a tax on the "privilege of using, consuming, distributing or storing tangible personal property after it is brought into this State from without this state." *Broadacre Dairies,* 193 Tenn. at 444-45. This definition is fairly uniform throughout the states. *See* 68 Am.Jur. Sales and Use Taxes §171 (1953). Thus, it was the legislative intent, as manifested in Section 67-3005, T.C.A., to impose a use tax on all tangible personal property imported from other states and used and consumed in this state, provided a similar tax, equal to or greater, has not been paid in the exporting state. *Young Sales Corp.* v. *Benson*, 224 Tenn. 88, 450 S.W.2d 574 (1970).

Liability for the tax may attach under two statutory sections. Under Section 67-3004, T.C.A., a contractor or subcontractor is liable for the use tax when he uses tangible personal property in the performance of his contract or to fulfill his contractual obligations. Section 67-3005, T.C.A., among other things, makes a "dealer" liable for the use tax on all tangible personal property he imports, or causes to be imported, and uses in this state.

Section 67-3016, T.C.A., provides that the tax is collectible from all persons engaged as dealers, as defined in Section 67-3017, T.C.A., to include "every person, as used in this chapter, who imports or causes to be imported, tangible personal property from any state ... for use, or consumption, or distribution, or for storage to be used or consumed in this state." The clear intent of the statutory scheme is to tax to the fullest extent permitted by the Commerce Clause, Article 1, Section 8 of the United States Constitution. *Texas Eastern Transmission Corp.* v. *Benson*, 480 S.W.2d 905 (Tenn. 1972). Goods moving in interstate commerce are exempt from the imposition of the tax. Section 67-3007, T.C.A.; *McLeod* v. *Dilworth, supra.*

Use is just one of the many rights contained in the bundle of rights known as ownership. *Henneford, supra.* This scheme of taxation is meant to encompass much more than simple title to and possession of the tangible personal property. The State has the power to tax storage of goods ultimately used in Tennessee. *Beecham Laboratories* v. *Woods*, 569 S.W.2d 456 (Tenn. 1978). Rental or lease of tangible personal property is a taxable event to which the use tax applies. *Crescent Amusement Co.* v. *Carson*, 187 Tenn. 112, 213 S.W.2d 27 (1948) (film prints rented for use in state). Installation of materials pursuant to a contract with a tax-exempt organization is taxed to the contractor who uses and installs those materials to fulfill his contractual obligation. *General Carpet Contractors, Inc.* v. *Tidwell*, 511 S.W.2d 241 (Tenn.1974).

The concept of use has not been confined to physical manipulation of the property. The taxable privilege of use extends to the "utilization of property for profit-making purposes." *See e.g., Union Oil Co. of California* v. *State Bd. of Equalization*, 34 Cal. Rptr. 872, 386 P.2d 496 (1963). Also taxable is the "power to allow property one owns to be used for one's benefit," for this is an "exercise" of "an incident of ownership under the Act." *Miller Brewing Co.* v. *Korshak*, 35 Ill.2d 86, 219 N.E.2d 494, App. Dismd. 386 U.S. 684, 18 L.Ed.2d 405, 87 S. Ct. 1325 (1966).

Especially illustrative of the utilization of property for profit-making purposes as an exercise of a taxable privilege is *Plowden & Roberts, Inc.* v. *Porterfield*, 21 Ohio St.2d 276, 257 N.E.2d 350 (1970). The facts of that case closely parallel the case at bar. The taxpayer was a South Carolina corporation which had contracted with a nonresident owner of Ohio real estate to construct a steel framework for a warehouse on the Ohio property. Pursuant to the contract, the nonresident contractor purchased the steel for the framework from sellers outside Ohio. These sellers delivered the steel on their trucks or by common carrier to the area where the warehouse was to be built. The taxpayer

then subcontracted the unloading and erecting of the steel to a North Carolina corporation. This corporation in turn subcontracted these tasks to an Ohio company. On these facts the Ohio Court held the nonresident contractor liable for the use tax on the steel.

The taxpayer in *Plowden, supra,* was considered a consumer under Section 5741.01, Page's Ohio Rev. Code Ann.:

> (F) "Consumer" means any person who has purchased tangible personal property for storage, use or other consumption in this state.

Under Section 5741.02, Page's Ohio Rev. Code Ann., a consumer, as defined above, is liable for the use tax.

The Ohio Court reasoned as follows:

> The law is clear that a person who has acquired from an out-of-state supplier tangible personal property for a consideration for storage, use or consumption in this state is liable for the use tax.
>
> It is undisputed that [the consumer] purchased steel for use in the construction of a warehouse in Ohio. That steel was delivered in Ohio and was used for the purpose for which it was purchased.
>
> The steel was delivered and came to rest in the State of Ohio before the tax was levied. Thus, at the time it was delivered and came to rest in Ohio, any previous attributes of interstate commerce which may have attached to the steel in transit were ended. (citations omitted)
>
> The authority for Ohio to assess a use tax against nonresidents based upon an agreement made outside Ohio for materials to be delivered in Ohio and used for the construction of a warehouse in Ohio was settled by this Court in *Rochez Bros.* v. *Bowers*, (1957), 166 Ohio St. 396, 400, 143

> N.E.2d 123, and *Tri-City Broadcasting Co.* v. *Bowers*, (1959), 169 Ohio St. 126, 158 NE2d 203. (other citations omitted)
>
> 257 N.E.2d at 353

The similarity between the Ohio and Tennessee statutes significantly underlines the importance of the holding in *Plowden, supra,* to the case at bar. The relevant portion of the Tennessee statute defines a dealer as one

> who imports or causes to be imported, tangible personal property from any state or foreign country, for sale at retail, for use, or consumption, or distribution, or for storage to be used or consumed in this state.
>
> Section 67-3017, T.C.A.

Unlike the Ohio statute, our statute does not require a purchase, but the effect of the two statutory sections is the same. A person who brings in materials from out-of-state to be used in this state is liable for a use tax.

IV.

Kelley had fabricated and delivered to the Memphis construction site the materials needed by North American and Delta to complete its subcontracts with Kelley. The materials were delivered, and came to rest within the state. They were unloaded and installed pursuant to Kelley's contracts with North American and Delta. Thus, this tangible personal property, brought into this state for use in construction here, became a part of the "the mass of property in this state." Section 67-3007, T.C.A.

Kelley used these materials to fulfill its contractual obligations. This use is a utilization of tangible personal property within the state for profit-making purposes and for the benefit of nonresident contractor Kelley. When a contractor brings in

materials from outside the state for use in this state on a project which benefits and profits that contractor, it has used the materials in such a way that it must be liable for the use tax. The language and intent of both Sections 67-3004 and 67-3005, T.C.A., are broad enough to encompass this situation and subject this taxpayer to liability for the use tax assessed. We find that liability for this taxpayer, primarily, is established by Section 67-3004, T.C.A., which is addressed specifically to the application of tangible personal property by a contractor or subcontractor.

Also subject to the use tax is the leased equipment. Kelley leased scaffolding and rigging, again pursuant to its contracts with North American and Delta, to be used at the construction site of the bulk mailing facility. North American and Delta personnel used this scaffolding in their work for Kelley. Here, as with the materials supplied by Kelley, the contract could not have been completed and Kelley would not have fulfilled its contractual obligations, had not the scaffolding been provided. This leasing of the equipment was a use of the property within this state such that a use tax is appropriate and reasonable. Kelley is liable for that tax, having utilized the property for profit-making purposes and to its benefit under its contract within Tennessee.

We conclude therefore that Kelley is liable for the use tax on the materials used to carry out the contracts with North American and Delta.

The ruling of the Chancellor is reversed and this cause is remanded to the Chancery Court for the computation of the correct amount of the final judgment.

Reversed and remanded.

/s/HENRY, J.

CONCURRING:
BROCK, C.J.
FONES, J.
COOPER, J.
HARBISON, J.

APPENDIX D

Constitution of the United States

Art. 1, §8. Powers of congress. -- [1]. The congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States;

[3] To regulate commerce with foreign nations, and among the several states, and with the Indian tribes;

* * * * * * *

APPENDIX E

TENNESSEE CODE ANNOTATED

67-3007. Interstate commerce exempt. — It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export; nor is it the intention of this chapter to levy a tax on bona fide interstate commerce. It is, however, the intention of this chapter to levy a tax on the sale at retail, the use, the consumption, the distribution, and the storage to be used or consumed in this state of tangible personal property after it has come to rest in this state and has become a part of the mass of property in . . .

* * * * * * * *

APPENDIX F

TENNESSEE CODE ANNOTATED

67-3002. Definition of terms. — The following words, terms, and phrases, when used in this chapter, shall have the meanings ascribed to them in this section, except when the context clearly indicates a different meaning:

* * * * * * * *

(h) "Use" means and includes the (exercise) of any right or power over tangible personal property incident to the ownership thereof, except that it shall not include the sale at retail of that property in the regular course of business.

* * * * * * * *

APPENDIX G

TENNESSEE CODE ANNOTATED

67-3004. Application of property by contractor. — Where a manufacturer, producer, compounder or contractor erects or applies tangible personal property, which he has manufactured, produced, compounded or severed from the earth, other than any severed from the earth and moved from one (1) place to another on the same construction or job site, such person so using the tangible personal property shall pay the tax herein levied on the fair market value of such tangible personal property when used, without any deductions whatsoever, provided, however, the foregoing shall not be construed to apply to contractors or subcontractors who fabricate, erect or apply tangible personal property which becomes a component part of a building, and which is not sold by them as a manufactured item.

Where a contractor or subcontractor hereinafter defined as a dealer, uses tangible personal property in the performance of his contract, or to fulfill contract or subcontrct obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the title holder of such property would be subject to pay the sales or use tax, except where the title holder is a church and the tangible personal property is for church construction, such contractor or subcontractor shall pay a tax at the rate prescribed by § 67-3003 measured by the purchase price or fair market value of such property, whichever is greater, unless such property has been previously subjected to a sales or use tax, and the tax due thereon has been paid.

* * * * * * * *

APPENDIX H

TENNESSEE CODE ANNOTATED

67-3018. Payment by dealer. — Every "dealer" making sales, whether within or outside the state, of tangible personal property, for distribution, storage, use, or other consumption in this state, or furnishing any of the things or services taxable under this chapter, shall be liable for the tax imposed by this chapter. [Acts 1947, ch. 3, § 4; C. Supp. 1950, § 1248.54 (Williams, § 1328.25); Acts 1955, ch. 51, § 11; ch. 307, § 1; 1969, ch. 3, § 1.]